TO: Ron
FROM: Don Stephens
RE: Criminal Corporate Case
DATE: 12/9/97

ISSUE 1: Can the 'General Manager' or 'Site Manager' who answers directly to the President, criminally bind the entire company?
ANSWER: Yes. The general rule is that a corporation may be held liable for criminal acts performed by its agents acting on its behalf. Further, the corporation can be held liable for a felony, if its commission was 'recklessly tolerated' by a 'high managerial agent.'

ISSUE 2: If the President of the company, knew of the 'General Manager's' illegal actions, and is also the president of a wholly owned subsidiary, can the subsidiary be held criminally liable as well as the parent company?
ANSWER: Yes, if the subsidiary is merely an alter-ego of the parent company, then the corporate veil can be pierced and both companies may be held equally liable.

FACTS:

The General(Site) Manager of a plant has committed a criminal act by fraudulently reporting on government documents. The General Manager makes all of the routine decisions about plant operations and reports directly to the President. The President was aware of the fraud and did nothing to correct the action. The President is also the president of a wholly owned subsidiary. This subsidiary is used solely for the benefit of the parent company. The corporations own literature refers to the subsidiary as 'corporate site or plant' and not as an independent corporation.

DISCUSSION:

1. The General Manager can criminally bind the entire corporation.

There is very little case law on bringing criminal actions against corporations. ["P]rior to the 1974 Penal Code a corporation or a partnership could not be indicted or tried under the criminal laws of Texas." Vaughan and Sons, Inc. v. State, 737 S.W.2d 805, 808 (Tex.Crim.App. 1987). "Today, however, the general rule is that a corporation may be held liable for criminal acts performed by its agents acting on its behalf." Id. at 806: (quoting) Tex.Jur.3d, Vol. 18, Criminal Law, Sec. 161, p. 232. The statute states that a corporation can be held criminally liable for an offense "performed by an agent acting in behalf of a corporation ... and within the scope of his office or employment," if the law is one that is intended to be applied to corporations." Texas Penal Code, sec. 7.22(a). Courts have been extremely liberal in finding that laws were intended to apply to corporations. Vaughan and Sons, Inc. v. State, 737 S.W.2d 805, 808 (Tex.Crim.App. 1987)(holding that a corporation can be guilty of criminally negligent homicide). An agent is defined as "a director, officer, employee, or other person authorized to act in

behalf of a corporation or association." Texas Penal Code, sec. 7.21(1). While corporations cannot possess a mental state, the corporation is still liable for unlawful acts of its agents if their conduct is within the scope of the agent's authority whether actual or apparent authority. U.S. v. Investment Enterprises, Inc., 10 F.3d 263 (5th Cir. 1993, rehearing and rehearing denied). Apparent authority is the authority which outsiders would normally assume the agent to have, judging from his position with the company and the circumstances surrounding his past conduct. U.S. v. Bi-Co. Pavers, Inc., 741 F.2d 730 (5th Cir. 1984). Further, the statue states, assuming the law applies to corporations that:

> [a] corporation ... is criminally responsible for a felony offense only if its commission was authorized, requested, commanded, **performed or recklessly tolerated** by:
> (1)a majority of the governing board acting in behalf of the corporation, or association; or
> (2) a **high managerial agent** acting in behalf of the corporation or association and within the scope of his office or employment.
> Texas Penal Code, sec. 7.22(b).

A 'high managerial agent' is defined in part as "an agent of a corporation or association who has duties of such responsibility that his conduct reasonably may be assumed to represent the policy of the corporation." Texas Penal Code, sec. 7.21(2)(C).

Under the framework of the statute, it would appear that at the very least that a general manager would be considered an 'agent' who could bind the company with a criminal action. As to a felony offense, the fact that the President of the company was aware of the offense and did nothing to correct it could amount to 'reckless tolerance' under the statute and act to expose the corporation to a potential felony offense. Further, one could allege that the General Manager was a high managerial agent and his actions alone could bind the corporation.

As to whether a 'general manager', specifically, can bind the corporation, there is no Texas case law on point, but there is a federal case that is instructive. It has been held that a 'Sporting Goods Manager" could expose the entire corporation to criminal liability through his illegal activity. U.S. v. Gibson Products Co., Inc., 426 F.Supp. 768 (D.C.Tex. 1976). This case is particularly instructive in that the manager was convicted of falsifying government documents (ATF forms for gun sales) like the defendant in our current case. The Sporting Goods Manager was found to have been acting in the course and scope of his employment even though he accepted bribes to falsify the papers. In determining liability

one must look to see if the employee (agent) had a "bona fide business purpose" in his illegal activity. Sundaco, Inc. v. State, 463 S.W.2d 528 (Tex.Civ.App. 1971, ref. n.r.e.). The court's logic was that the sales were intended to benefit the corporation and that the corporate president was derelict in his supervision of the sales. It is much easier in our case to say that the Manager intended to benefit the corporation by his action as there is no record of a personal motive.

2. Under the Alter Ego Theory, the Corporate Veil can be pierced and the wholly owned subsidiary can be found criminally liable along with its Parent Corporation.

The Alter ego doctrine allows one to disregard the 'legal fiction of the corporate entity ' and is 'an exception to the general rule which forbids disregarding corporate existence.' Lucas v. Texas Industries, Inc., 696 S.W.2d 372, 374 (Tex. 1984). The burden of proving that a corporation is the alter ego of another is a difficult one. Courts seem reluctant to apply the doctrine unless there is an equitable reason, such as fraud on the part of the corporation.

Alter ego applies when there is such unity between corporation and individual (or parent corporation) that the separateness of the corporation and individual has ceased and holding only the corporation liable would result in injustice. Castleberry v. Branscum, 721 S.W.2d 270, 272 (Tex. 1986). The rationale is that "if the shareholders themselves disregard the separation of the corporate enterprise, the law will also disregard it so far as necessary to protect individual and corporate creditors." Id.; (quoting) Ballantine, Corporations, Sec. 123, at 294 (1946). Specifically, the corporate fiction is disregarded:

> (1) when the fiction is used as a means of perpetrating fraud;
> (2) where a corporation is organized and operated as a mere tool or business conduit of another corporation;
> (3) where the corporate fiction is resorted to as a means of evading an existing legal obligation;
> (4) where the corporate fiction is used to circumvent a statute; and
> (5) where the corporate fiction is relied upon as a protection of crime or to justify wrong.
> Id; Roylex, Inc. v. Langson Bros. Const. Co., 585 S.W.2d 774, 778 (Tex.Civ.App.-Houston [1st Dist.] 1979, writ ref'd n.r.e.); Wolf v. Little John Corp. of Liberia, 585 S.W.2d 774, 778 (Tex.Civ.App.-Houston [1st Dist.] 1979, writ ref'd n.r.e.).

In our current case, it could be argued that the second and fifth rationales apply. The subsidiary has been described, by the parent's own documents, as being a corporate site, and not as a separate corporation. Thus it could be argued that it is an alter ego. It could also be argued that if the corporate fiction was allowed to remain intact, it would act to wrongfully shield the subsidiary from the consequences of a crime.

In determining if there is an abuse of the corporate privilege, courts must look through the form of complex transactions to the substance. One must see if the parent and the subsidiary company have truly kept their existence's separate. "Alter ego is often established by evidence showing a blending or identities, or a blurring of lines of distinction, both formal and substantive, between two corporations." Hideca Petroleum Corp. v. Tampinex Oil Intern., Ltd., 740 S.W.2d 838, 843(Tex.App.—Houston [1st Dist.] 1987, no writ.). The corporate formalities must be maintained and the structure and transaction must be examined to see if they have kept separate: offices, employees, stationary, stock, written records, tax returns, bank accounts, meetings of directors and shareholders as well as other indicators of separate existence such as the independent financial stability of the subsidiary. Castleberry v. Branscum, 721 S.W.2d 270, 276 (Tex. 1986). "Other factors such as the identity of shareholders, directors, officers, and employees, failure to distinguish in ordinary business between the two entities, and failure to observe proper formalities, are important." Hideca Petroleum Corp. v. Tampinex Oil Intern., Ltd., 740 S.W.2d 838, 843(Tex.App.—Houston [1st Dist.] 1987, no writ.). One or more of the above factors alone are not enough to disregard the corporate existence, instead the 'total dealings' of the corporations should be examined. Castleberry v. Branscum, 721 S.W.2d 270, 276 (Tex. 1986).

I have been unable to find a alter ego case involving a criminal prosecution of a corporation. There may be a fundamental difference between how the doctrine applies in civil cases and criminal cases. A distinction has even been drawn between torts and contracts, with courts more willing to disregard the corporate existence in tort cases. Lucas v. Texas Industries, Inc., 696 S.W.2d 372, 375 (Tex. 1984). The courts rationalized that in contracts there are prior dealings with the defendant corporation and the risk of deception is less. Id. The rationale in a criminal case is much different than in a civil case. In civil actions, the main concern is the financial strength of the subsidiary so that the plaintiff may be fully

compensated. In criminal actions, were are more concerned about the unity of leadership. The main motive in a criminal investigation whether the subsidiary was used as a tool of the parent company to perpetuate an illegitimate end or whether the subsidiary can be used as an escape mechanism to prevent the total corporation from feeling the full weight of the punishment. Thus the focus is on whether leaders in both companies 'recklessly tolerated' an illegal action by an agent and not on financial matters. In Lucas, it was held that the fact that the parent corporation and subsidiary shared all the same directors, filed consolidated income tax returns, and conducted inter-corporate business constituted no evidence of alter ego in a tort case as the plaintiff did not 'fall victim to a basically unfair device by which [defendant's] corporate entity was used to achieve an inequitable result.' Id. at 376. This unity of leadership is exactly what would allow the prosecution of both companies in a criminal action. Thus this case is distinguishable.

I hope this is helpful, as there is very little case law on criminal actions on corporations. If I can help you further, or clarify something, please let me know.